The FSA to Raise Awareness of Evolving Issues

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At the 35th Annual General Meeting of the IBA Japan

November 25th 2019

1. Introduction

It is my great honor to be here again. I really appreciate the efforts taken by IBA to arrange this meeting and the opportunity to present our approach to address the current issues.

My presentation is titled “the FSA to raise awareness of evolving issues”. The reason why I set this title is that in this transformation phase for the financial industry, we would like to keep ourselves prudent and prepared for incoming changes with the engagement with wide range of stakeholders, especially with the international financial industry.

To exemplify our approach, I would like to mention four issues, which are;
“Evolution of Financial Technologies”,
“SDGs Finance”,
“Market Fragmentation”, and
“Reforming Agenda for the FSA”

Let me say some words around my basic observation of how we see our role as being regulator and supervisor.

If the markets are perfect, there would be no need for the public sector to intervene. But, as everybody knows there is no perfect market literally. Maintaining sound financial market structure and platforms through setting out rules and ensuring them through supervision are the roles for us to play.

In addition, merely maintaining soundness is not the end of the line. We have been and will be well aware of the latest positive
developments. Good examples can be seen in the ecology space. We think Sustainable Development Goals is one of the key areas to be focused. This is because SDG investments have the possibility to internalise the external dis-economy into market mechanism.

Recent years we have been observing the uncertainty and instability that influence international markets. This involves with social unsustainability and geo-political risk which are mostly seen outside of Japan.

This gives relative advantage for the FSA because we are in Japan where the political and social stability has been relatively maintained.

Not only the stability, but also our position provides us the unique strength. First, the FSA acts as the integrated financial supervisor which is not recently seen among major developed countries where regulatory functions are demarcated by multiple financial authorities. Second, the FSA can submit laws to parliament and has the authority to officially stipulate the rules and guidelines while in many jurisdictions financial supervisors do not.

Taking advantage of this uniqueness, the FSA is in the first group of financial authorities to introduce the supervisory regime over crypto-asset brokers.

In addition, the position also contributes to strongly advancing the function-based, cross-sectoral regulations, which is a worldwide trend in response to the rapid development of information technology.

With these respects, we are able to commit to policy issues in a timely manner and also address the fast-changing market issues with multifaceted functions embedded to us.

Leveraging our unique position, we address the emerging policy agenda we face and ask ourselves to explore the efficient approaches to such confronting issues.

The first agenda concerns the fast-paced technological evolution in financial market, which has been brought by FinTech. “Under the situation where innovation rapidly growing, how do we react to it and design new regulatory approaches to counter it?”
Second is about SDGs. “Will SDG investments be able to bring about the more efficient market structure by internalizing the social dis-economy into market mechanism?”

Third, “Financial regulations are fragmented across jurisdictions. Is there a way for more consistent and efficient rules and supervision for international financial players?”

Lastly, but importantly for me, is the question on our own development. “In this ever changing world, how should the FSA fit ourselves for the future?”

We think the consideration on these questions must be done with prudent thinking so that our approach will strengthen the confidence on the positive side of market mechanism, and reinforce the stability for growth.

Let me dive deeper in these areas.

2. Evolution of FinTech

Considering today’s innovative environment for FinTech, I believe most people here observe that the new technology has a potential to change the financial landscape in the coming years. We also feel that the FinTech will transform the structure of financial businesses as well as underlying risks by experiencing such changes of business. And fast-paced digitalization may provide a quantum leap in managing huge data stocks as well as developing data analytics with new technologies such as AI.

Under this situation, we have set out the new FinTech and digitalization strategy which addresses five key issues as illustrated in the slide.

The “data strategy” located in the first square is prioritized in the new strategy, as utilizing data while preserving data privacy in financial business is of high interest for many financial stakeholders. Of course, we continue to stick to providing “supports for innovation” to FinTech start-ups, building “faction-based and cross-sectoral
financial regulations” that anticipate new FinTech players and designing the “digitalization of regulatory infrastructure” for better interactions with industries.

On top of that, the new proposal of a so called “stable coin”, as typified by Facebook’s Libra, is drawing attention in financial space. And there is growing international interests in how we address it in light of legal, regulatory and oversight challenges and risks. G7 working group on Stablecoins in mid-October has published the final report that provides comprehensive mapping of risks and challenges posed by stablecoins. As you well know, Japan has this year’s presidency in G20. G20 Finance Ministers and Central bank Governors agreed at its meeting in October that these risks need to be evaluated and appropriately addressed before global stablecoins and other similar arrangements with potential systemic footprints can commence operation.

As a part of G20 efforts, technological innovations in decentralized financial technology, which is underpinning technology for crypto-assets, were identified as an important agenda. As blockchain, which represents the technology with decentralization and autonomy, develops, we are likely to face unknown situations in future in light of financial regulation and its enforceability. Thus we should explore new approaches and frameworks for creating better governance system, without sticking to conventional ways. That said, because the FSA had already implemented the supervisory regime over crypto-assets brokers, we believe we are relatively better positioned among regulatory bodies among jurisdictions in this space.

Just three months ago, G20 leaders have discussed the technological innovation of financial system, anticipating the decentralized technology will be deployed with an environment where benefits can be attained. As illustrated, the leaders have agreed on the importance for regulators to engage with other stakeholders including engineers, businesses, users and academia who are globally active in the ecosystem.

Based on this, we should take further steps into new dimension for new global coordination and cooperation with a variety of stakeholders. In this context, JFSA will lead this initiative and create
a new forum next March to discuss better governance of decentralized financial system participated by multi-stakeholders.

3. SDGs Finance

What we understand is that some global financial firms started their efforts to analyse the risk associated with sustainability by using stress scenarios in the middle of 2000s. Since then public awareness on SDGs has been raised significantly by the several abnormal weather events, such as the hurricane Katrina hitting the south coast of United States in 2005.

Japanese government has been clear in arguing for the investments to SDGs. The reason behind is that the investments have the possibility to internalise the external diseconomy. As this is the evolving issue, the FSA will continue to monitor whether the track of better-off dynamic equilibriums would be achievable or not.

In line with the Japanese government’s approach, the FSA is using our tools to support the SDGs.

First, Corporate Governance Code and Stewardship Code encourage investors and companies to have constructive dialogues, to promote sustainable corporate growth and increase corporate value over the mid- to long-term.

Second, to further facilitate informative disclosures and constructive dialogues between investors and companies, the TCFD Consortium of Japan was established this May with the initiative of private sector. The consortium is a platform to discuss climate-related disclosures in line with the International TCFD recommendations. The FSA, the METI and the Ministry of the Environment support the discussions as observers.

As the first product by the consortium, “the Guidance for Utilizing Climate-related Information to Promote Green Investment” was published this October. This guidance provides the perspectives needed for institutional investors and financial institutions to evaluate disclosures by business corporations.
This is another approach to challenge the information asymmetry problem. In other words, this is an effort to make “invisible hands” functioning better by “visible hands” among market participants.

4. Market Fragmentation

Addressing market fragmentation is one of the priorities set out under the Japanese G20 Presidency. In the aftermath of the global financial crisis in 2008, a large number of common international standards including Basel III were agreed by financial authorities. While these agreements have been important milestones and achievements to make global financial system more open and resilient, several concerns have been raised by market participants as well as authorities with respect to the openness of the financial system and preventing the financial market from being fragmented.

For example, when the agreed international reforms are adopted and implemented by each jurisdiction, in some cases, its domestic rules have developed in a slightly different manner or have been implemented with different timelines from the agreed schedule. These discrepancies between national rules could impose unintended extra burdens on international financial institutions.

Against this background, the G20 asked two international standard setting bodies, the FSB and IOSCO, to address market fragmentation issues. They published the reports in June this year and the G20 Leaders welcomed those work at the G20 Osaka summit.

The FSB report sets out that some types of market fragmentation could undermine financial stability and market efficiency, for example through limiting opportunities of investors and financial institutions to manage capital and liquidity across national borders, and the report identified several areas for further work to address unintended market fragmentation.

Meanwhile, the IOSCO report examines and describes the main drivers of potentially harmful market fragmentation and presents key specific instances of such fragmentation. It also suggests possible approaches to facilitating use of deference, which allows market
participants to follow their home regulations which have similar objectives and comparable outcomes to the foreign regulations.

The report also notes that “one-size-fits-all” approach would not be appropriate in deferent process because factors to be considered and priorities of those could vary among jurisdictions in determining whether to defer to foreign regulatory regimes.

Hence, it would be a sensible and practical approach to identify good or sound practices based on the experiences among jurisdictions accumulated through deference assessment. For example, the IOSCO report introduces the case where the regulators of Asia-Pacific countries including Japan developed a common questionnaire and shared responses each other in the assessment process, instead of conducting assessment on a bilateral basis. The intention was to make the deference assessment process more efficient. I think that applying such useful approach to other possible cases of deference assessment would be beneficial.

Here, I would like to briefly mention that the journey we started to address market fragmentation is not solely led by the FSA but also with the international financial industry. January this year, IIF, Institute of International Finance, and ISDA, International Swaps and Derivatives Association, clarified their position with their reports and provided the momentum to roll the ball. The FSA is going to continue to maintain constructive relationships with international financial industry.

5. Reforming Agenda for the FSA

Changing oneself to fit for the future is a difficult task for everyone. Especially when there is uncertainty like today. Let me explain our reforming agenda.

In light of the changes in nature of the supervisory issues, the FSA has been reforming itself both in its culture and supervisory approaches.
Upon the establishment of the FSA, the most important issues were twofold. First is resolving the non-performing loan problem. Second is protecting investors.

To deal with them, the FSA resorted to supervisory approaches that focused on ex-post compliance checks and asset quality reviews, which helped the FSA to resolve the issues at that time.

However, the environment and priority issues have changed since then. We are now facing; persistent global low interest rates and aging and declining population, which lead to various needs of financial services and accelerating change in sources and types of risk for financial institutions.

As a result, the FSA changed its supervisory approaches from enforcement of minimum standards to dialogues to explore best practices including sustainability of business models and risk management together with deploying macro-prudential supervision.

In addition, effective and honest communication is the key to develop better internal and external relationships.

We are mindful of the risk that directional supervisory approaches may lead financial institutions toward short-sighted business deviating from the mutually beneficial and ultimate customer-centric business. Our current approach is to lead our front supervisors to make more in-depth interactive dialogues with financial institutions. We call this “shift from chain of direction to chain of interactive dialogue”

With this, we are trying to provide “psychological safety” inside and outside the FSA.

Psychological safety is an atmosphere where everyone may speak out or take actions without refraining.

My firm belief is that embedding psychological safety in internal communication at the FSA will lead toward the better communication with financial institutions as securing psychological safety is involved with the development of fundamental communication skill-set for our front supervisors.
In addition, we will continue to learn from the financial and non-financial industry to raise our level of management skill-set. This is one of the pieces we are taking as a valuable information to think about how we will embed and operationalize the management approach into our practice.

6. Conclusion

Let me conclude my session. We have been facing uncertainty and geo-political risk which persistently affect the financial industry. I would say, this is like a rainy weather. As a result, everybody is wondering whether it is going to pour or not.

Nobody can predict the future and nobody can answer the question. But the obvious fact is that we have already found out the seeds for the positive progress in many areas which I mentioned previously.

We believe the important thing for the FSA is to be prudent and thoughtful in our supervision process. That means, while paying due respect of the market mechanism, if found necessary, we will try to find the right place to step in.

After the financial crisis in 2008, regulators globally have been requiring international banks to raise capital. Before we open our door to 2020s, we see that the effort to raise capital seems to be reaching its goal sooner or later.

Then what will come next? We believe raising awareness is the key to our next steps. Awareness of the risk and growth possibility arisen from evolving issues is an integral part for our disciplined decision.

Mindful of this, the FSA will engage with the wide range of stakeholders including the international financial industry to facilitate financial function which works better with soundness and market integrity.

Thank you very much for your attention to my speech.